Professor Wigmore points out clearly,[16] that the overt act does not represent the real intention of the signer. What, then was the releasor's real intention here? A releasor never has the general intent merely to sign a "release," but always the specific intent to sign a particular kind of release. The test should be, Does the misrepresentation go to the essence of the instrument?[17] The omission of a promise of life employment does go to the essence, just as much as an addition or substitution of terms would, and the instrument ought therefore be considered void *ab initio*. This is the conclusion which has been reached in other jurisdictions where the question has arisen.[18]

Technical difficulties such as the above, which unduly hamper the courts, even where they are inclined to be liberal, as in California,[19] are inevitable as long as personal injury claims and releases thereof are governed by the general rules of tort and contract. But to a great extent the rules of tort on the whole subject of personal injury claims have been rendered obsolete by the possibility of social insurance.[20] The Workmen's Compensation Act,[21] which is the chief manifestation of the new tendency, furnishes likewise a solution of the subsidiary problem of the fraudulent release, by requiring the approval of the Industrial Accident Commission.[22] In this respect, as well as in major matters, the principles of the Act should be applied to negligence cases in general. *H. R.*

CORPORATIONS: NON-LIABILITY TO CORPORATION CREDITORS OF INNOCENT PURCHASER OF WATERED STOCK—Mr. Justice Olney has contributed a good deal to the clarifying of a hitherto much-confused branch of the California law of corporations, in *Rhode v. Dock-Hop Company*.[1] Here it was held that a transferee of

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[16] 4 Wigmore on Evidence, p. 3394 ff.

[17] See 4 Brit. Rul. Cas. 663.

[18] McDonald v. Central Ry. Co. (1916) 39 N. J. L. 251, 98 Atl. 391; Hayes v. Atlanta Etc. Air Line R. R. (1906) 143 N. C. 125, 55 S E. 437, 10 Ann Cas. 737.

[19] Releases have been set aside in California in the following cases: Wilson v. S. F. Oakland Terminal Ry. (1920) 32 Cal. App. Dec. 680, 191 Pac. 925 (fraud and undue influence, with dictum to the effect that neurasthenia, if present, would give rise to an even closer scrutiny); Carr v. Sacramento Clay Products Co. (1917) 35 Cal. App. 439, 170 Pac. 446 (fraud, mistake, undue influence, mental incapacity); Edmunds v. S. P. Co. (1912) 18 Cal. App. 532, 123 Pac. 811 (fraud, undue influence); Meyer v. Haas, supra, n. 3 (fraud and mistake); Smith v. Occidental etc. S. S. Co. (1903) 99 Cal. 462, 34 Pac. 84 (undue influence). The court has refused to invalidate the release in the following cases: Haviland v. S. Calif. Edison Co. (1916) 172 Cal. 601, 158 Pac. 328; Rogers v. Atchison etc. R. Co. (1918) 38 Cal. App. 343, 176 Pac. 176; Garcia v. Calif. Truck Co., supra, n. 8.

[20] See note in 8 California Law Review, 269, and references cited therein.

[21] Workmen's Compensation Act, Cal. Stats. 1917, ch. 586.

[22] Idem, § 27 (b).

[1] (Nov. 20, 1920) 60 Cal. Dec. 599, 194 Pac. 11.

overvalued stock, who did not participate in the transaction whereby the stock was issued, could not be held liable to creditors of the corporation for the difference between the issue value and par, in the absence of a showing that he knew the facts surrounding the issue of the shares.[2] The opinion is interesting chiefly because of the distinction drawn between partially paid stock issued as such, and overvalued or watered stock.[3] As the court states, "the two cases are much confused and it is not infrequently sought to apply to one class of cases the principles applicable to the other"—a fact which may well be the excuse for a brief inquiry into the basis of the stockholder's liability in both classes of cases.

Where stock is issued by the corporation as partially paid, a person accepting such stock agrees expressly or by implication to be liable to the corporation upon call for the unpaid balance. If the corporation becomes insolvent, this obligation of the stockholder can be reached by a creditor as an asset of the corporation, and although the creditor can sue the stockholder directly without requiring a call by the company,[4] the creditor's right against the stockholder is coextensive with that of the corporation. The basis of the stockholder's liability is thus a contract duty.

Where the certificate is in the form of full-paid stock, however, even though the corporation did not intend to issue the shares as such, an innocent transferee without notice that anything remains unpaid, is, according to the majority rule, exempt from liability.[5] As to certificates issued prior to the 1905 amendment to section 323 of the Civil Code,[6] the California rule has been contra to this view, holding even a bona fide transferee liable to a call for the

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[2] Reversing the judgment in the District Court of Appeal (30 Cal. App. Dec. 47). See 8 California Law Review, 253.

[3] Supra, n. 1, at p. 604. "It is to be noted at the outset that there is a marked difference between the case of one acquiring and accepting stock which is only partially paid and does not purport to be otherwise, and the case of one acquiring and accepting stock which purports to be fully paid, but is not in fact; which is, in other words, what is commonly known as watered stock. The difference between the two kinds of stock is apparent and is thoroughly well recognized, and the liability of the owner in the one case to make good upon call his share of the unpaid balance of his capital of the company and his liability to do so in the other case depend upon entirely different principles."

[4] Daggett v. Southwest Packing Co. (1909) 155 Cal. 762, 103 Pac. 204; Clarke on California Corporations, p. 390.

[5] See notes in 3 Ann. Cas. 1120, Ann. Cas. 1914B 748, 30 L. R. A. (N. S.) 283; 4 Thompson on Corporations (2d. ed.) § 4385; although it should be stated that the cases cited therein, with a few rare exceptions, fail to make the distinction made in the principal case.

[6] "All corporations for profit must issue certificates for stock when fully paid up, signed by the president and secretary, and may provide, in their by-laws, for issuing certificates prior to full payment, under such restrictions and for such purposes as their by-laws may provide, but any certificate issued prior to full payment must show on its face what amount has been paid thereon."

unpaid installments on his shares.[7] The code section requiring the amount due on stock issued prior to full payment to be stated on the face of the certificate would seem to make this notation a condition precedent to the preservation of the corporation's right against a stockholder for the balance,[8] that is, against a transferee without notice that anything remains due.[9] In other words, the section now makes the issuance of a certificate which upon its face does not show that it is partially unpaid a representation by the corporation that it has received par value, and as against a bona fide purchaser of the stock, the corporation would be estopped to maintain an action for the unpaid balance; which means that the creditor could stand in no better position.[10]

Where stock is issued, however, as full-paid at a discount or at an overvaluation, the very basis of the transaction between the parties concerned is that the shareholder owes no duty to the corporation to make good the difference. Yet it is well settled that against a stockholder participating in the issue, a corporation creditor can recover. Obviously, here is a different liability from that just considered, yet a surprisingly large number of cases and text-books fail clearly to distinguish the two. While the liability in this last case is well established, the theoretical basis on which it rests is not always uniformly laid down. It is not proposed here to discuss the various theories.[11] It should be noted, however, that the Rhode case definitely sounds the knell of the "trust-fund" theory in California, which, since its introduction into this juris-

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[7] Perkins v. Cowles (1910) 157 Cal. 625, 108 Pac. 711, 137 Am. St. Rep. 158, 30 L. R. A. (N. S.) 283; O'Dea v. Hollywood Cemetery Assn. (1908) 154 Cal. 53, 97 Pac. 1; Geary, etc. Co. v. Bradbury, etc. Co. (1918) 179 Cal. 46, 175 Pac. 457, 7 California Law Review, 61. See an adverse criticism of the Perkins v. Cowles doctrine in 71 Central Law Journal, 23.

[8] The cases cited supra, n. 7, all dealt with stock that had been issued prior to the amendment to the code.

[9] It is hardly necessary to add that a transferee who knows that there are unpaid installments can be held to assume the liability to pay them: 4 Thompson on Corporations (2d. ed.) § 4386; and for cases where purchasers with notice have been held, see Ann. Cas. 1914B 754, note; and the case of People's Home Savings Bank v. Sadler (1905) 1 Cal. App. 189, 81 Pac. 1029, where the by-law was printed on the certificate.

[10] Query, whether the transferee would have to be a purchaser *for value* to escape liability? Suppose the corporation enters the issue on the books as partially unpaid, but no entry is made on the certificate; then the original subscriber gives the stock without consideration to a transferee without notice; can the transferee be held? No case has been found discussing the liabilities of an innocent transferee who did not give value for the certificates. It may be argued that he is in the situation of a donee of trust property, and therefore liable to the extent of the property received.

[11] For a discussion of the various theories, see 2 California Law Review, 237; 29 Harvard Law Review, 854; 13 Yale Law Journal, 66; 62 University of Pennsylvania Law Review, 133; 4 Virginia Law Review, 131.

diction, has had a troubled and stormy career. Sherman v. Harley[12] really gave it its mortal blow, but it remained for the principal case finally to accomplish its demise. Following the trail blazed by Justice Mitchell some thirty years ago,[13] the court has established the "fraud theory" in California.[14] The creditor is allowed to impeach the overvalued issue as a fraud upon him, the basis of the shareholder's liability being in the nature of tort. The result is that a transferee of the stock, to be held liable, must in some way be connected with the fraudulent issue; and where he took his stock unaware of the character of the transaction, he should not be placed under any liability of this sort.[15] The principal case very properly holds that the doctrine of purchasers for value has no application to this situation and the fact that the defendant paid no consideration for the stock was held to be immaterial. If it can be shown that the party took the certificates neither participating in nor knowing anything of the representations, nothing more need be shown to make out his immunity.[16]

H. A. B.

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[12] (1918) 178 Cal. 584, 174 Pac. 901, 7, A. L. R. 950, 6 California Law Review, 463, holding that a creditor who has full knowledge of the facts that the issue was at an overvaluation cannot recover—a result, of course, inconsistent with the "trust-fund" theory. On this point of knowledge of the creditor, see note in 9 California Law Review, 61. If, however the stock is issued as unpaid stock, the knowledge of the creditor in immaterial.

[13] In the leading case of Hospes v. Northwest Manufacturing Co. (1892) 48 Minn. 174, 50 N. W. 1117, 31 Am. St. Rep. 637, 15 L. R. A. 470.

[14] This theory does not mean that all the elements of common-law deceit must be present. At least the plaintiff need not prove that he dealt with the corporation believing that the stock was paid for; all he need show is that he was creditor after the issue of the overvalued shares, and if he dealt with the corporation with knowledge of the discounted issue, this is a matter of defense. See the Hospes case, supra, n. 13, and authorities cited in 9 California Law Review, 61.

[15] This is the overwhelming weight of authority. See 6 Fletcher, Cyclopedia of Corporations, § 3771; 4 Thompson on Corporations (2d. ed.) §4399; Brant v. Ehlen (1882) 59 Md. 1, seems to be the leading case. By statute in a few jurisdictions, the innocent transferee is held, New York, for example. See White, Corbin & Co. v. Jones (1901) 167 N. Y. 158, 60 N. E. 422; Are Innocent Purchasers of Watered Stock Liable for Debts of the Corporation?; 3 Bench and Bar (New Series) 109. The prevailing view is criticised in 15 Harvard Law Review, 844.
The holding in the principal case reverses Zierath v. Claggett (1920) 31 Cal. App. Dec. 406, 188 Pac. 837, on this point, although the latter case is not mentioned in the opinion. The Zierath case mistakenly applied the Perkins v. Cowles rule to watered stock, not mentioning Cal. Civ. Code, § 323. See Professor Warren's criticism of Zierath v. Claggett in 34 Harvard Law Review, 287.

[16] The cases are prone to talk about "negotiability" and "quasi-negotiability" in connection with these situations involving shares of watered stock. Negotiability is really a false quantity here. The liability of the stockholder is not based on any charge or lien against the shares, but in the nature of fraud, as has been seen. The rule protecting an innocent purchaser will, of course, tend to make shares of stock more readily marketable—but that does not mean that the certificates are thereby made negotiable in any proper sense.